No. 17954

UNITED STATES COURT of APPEALS

FOR THE NINTH CIRCUIT

SHERWOOD & ROBERTS - KENNEWICK, INC., a Washington Corporation, Appellant

v.

ST. PAUL FIRE & MARINE INSURANCE COMPANY, a Minnesota Corporation Appellee.

Appeal from the United States District Court for the Eastern District of Washington Southern Division

REPLY BRIEF OF APPELLANT

WILLIAM M. TUGMAN

SHERWOOD, TUGMAN AND GREEN

601-611 Baker Building Walla Walla, Washington

Attorney for Appellant

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ST. PAUL'S COUNTER-STATEMENT OF THE CASE

In our opening brief we set forth objectively the facts relating to the issues presented on this appeal and supported them with detailed references to the transcript of evidence and to the exhibits.

Appellee's counter-statement set forth the evidence most favorable to appellee (Appellee's Brief, p. 2). Summarized, this "favorable evidence" is excusatory, not exculpatory.

For every action there was an excuse, not a denial. There is no excuse for dishonesty.

We will not make a detailed restatement of the facts and will comment only briefly on appellee's restatement.

Appellee claims that S&R had knowledge of Chamberlin's actions because a monthly Finance Loan Register was submitted by him to S&R—Walla Walla. The fact is the Finance Loan Register is an accounting document which is fed into an I.B.M. machine to show the total volume of business, earned discounts, reserves, etc. A loan appears on the Finance Loan Register only once—the month in which the loan is made. Thereafter it does not reappear (Tr. 1665). Delinquent loans are not reported on the Finance Loan Register. It would be impossible to determine delinquencies, financial stability or loan status from the Finance Loan Register. (Def. Exs. A-10, A-31).

Appellee apparently contends that the sheer volume of business done by S&R with Walker excuses all Chamberlin's conduct in respect to the Walker accounts (Appellee's Brief, pp. 3 & 4).

Based on figures set forth by appellee, the total interest charged and received by S&R on loans made to Walker and his companies during the period 1953 to 1959 was only slightly more than 2% (Appellee's Brief, p. 3).

Appellee relies heavily upon the contention that Walla Walla failed to make sufficient funds available to Chamberlin to allow him to take care of business in the Tri-City area. Shortage of funds necessary to correct book overdrafts was given as the excuse for the Chamberlin - Walker check kiting. On October 10, 1958, as it had before, S&R advised Chamberlin:

> ". . . If you need additional funds to overcome book overdrafts, please advise me and the funds will be advanced accordingly. . . ." (Plfs. Ex. 84 at p. A-1, Appendix).

Other points raised by appellee will be dealt with in our argument.

ARGUMENT

ERRORS 1, 2, 3, 4, AND 5

A. THE ISSUE OF DISHONESTY WAS ELIMINATED FROM THE CASE.

The Eighth Circuit Court of Appeals characterized an employee's conduct as dishonest within the meaning of a fidelity bond as follows:

> "The test is not whether he intended to personally profit by his course, though that he did is perhaps a permissible inference from the facts shown. He occupied a position of trust and confidence which he secretly betrayed. He received compensation for guarding the interests of his employer and he was wilfully, intentionally and grossly faithless." *United*

States Fidelity and Guaranty Co. v. Egg Shippers S & F Co., 148 F. 353, 355.

Justice Cardozo held that dishonesty within the meaning of an indemnity contract:

> "may be something short of criminality . . . the measure of its meaning is not a standard of perfection, but an infirmity of purpose so opprobrious or furtive as to be fairly characterized as dishonest in the common speech of man . . . "
>
> *World Exchange Bank v. Commercial Casualty Ins. Co.,* 255 N.Y. 1; 173 N.E. 902, 903. Appellee's Brief, p. 47.

Compare the definition of fraud set out at Page 61 of appellee's brief:

> "It (fraud) consists of some deceitful practice or willful device, resorted to with intent to deprive another of his right, or in some manner to do him injury . . . " *Brown v. Underwriters at Lloyds,* 53 Wn. (2d) 142; 332 P. (2d) 228.

The Trial Court compelled a finding of fraud as a condition precedent to liability when he instructed:

> "Therefore, if you find that fraud or dishonesty, or both, *including intent to defraud the plaintiff* have been proved to your satisfaction . . . the plaintiff has sustained its burden of proof . . . " (emphasis supplied)

and:

> "However, if you find that neither fraud nor dishonesty, *including intent to defraud the plaintiff* have been proved to your satisfaction . . . the plaintiff has not sustained its burden of proof . . . ." (Tr. 2300-2301; emphasis supplied.)

Fraud may embrace dishonesty but dishonesty does not embrace fraud.

The Court's requirement of "intent to defraud" squares with the definition of fraud in Brown v. Underwriters at Lloyds, but does not conform to any definition of dishonesty as applied to a fidelity bond that we have been able to find. The Court's requirement that the jury find "intent to defraud" prevented the plaintiff from getting a hearing on the issue of dishonesty. St. Paul specifically insured against dishonesty. Insurance against dishonesty represented part of the consideration for the contract. With this eliminated, appellant was deprived of the consideration for which it paid its premiums (Pl. Ex. 1).

At the least Chamberlin's dishonesty was evidenced by a want of integrity and breaches of trust. His acts involved consciously wrongful conduct involving moral turpitude. The bond was written to idemnify S&R against losses resulting from the commission of consciously wrongful conduct of a nature which is wilfully, intentionally, and grossly faithless. 45 C.J.S. Insurance, Sec. 802, p. 852; *United States Fidelity & Guaranty Co. v. Egg Shippers S & F. Co.,* 148 F. 353, 355; *Foster v. Bowen,* 311 Mass. 359; 41 N.E. (2d) 181.

B. THE CHAMBERLIN-WALKER DEALS: A HISTORY OF DECEIT

Check Kiting

The history of the Chamberlin-Walker deals is one of calculated deception and deceit. Each concealment and misrepresentation of a material fact by Chamberlin from his employer created the necessity for still another deception. To remain buried, every past act of deceit required the perpetration of another act of

deceit. Like a pebble thrown into still water, the initial splash created an ever-widening circle of disturbance.

The initial deceptions took place between December 26, 1957 and September 24, 1958, when Chamberlin and Walker kited checks between WalkerMotors and S&R totalling $157,580.00 (Tr. 1382-1387, 1402-1404). The check kitings were more than acts of deceit. Neither Walker Motors nor S&R had sufficient funds in the bank to meet the checks in full upon presentation (Tr. 991-993, 1402-1404). Precise timing was required to prevent the checks from bouncing. R.C.W. 9.54.050 provides that any person who makes, draws, utters or delivers a check on a bank knowing that there are insufficient funds on deposit to meet the check shall be guilty of larceny.

Appellee states that the checks were kited to eliminate an overdraft on the books of S&R—Kennewick (Appellee's Brief, p. 11). The actual and intended effect was to conceal from the home office the overdraft which existed at month's end. In point of fact, the bank account itself was frequently overdrawn. See Ex. 84, p. A-1, Appendix.

Chamberlin had been warned repeatedly of overdrafts and was told that inter-company borrowings between Fairway—Kennewick and S&R—Kennewick would not be tolerated. *The home office was ignorant of the Walker-Chamberlin check kiting.* Edwards' memo (Pl. Ex. 84) on the subject is set out in the Appendix, p. A-1.

Seeking to excuse Chamberlin's conduct, appellee

implies on pages 10-12 of its brief that S&R condoned the check kiting. Not one reference is cited by appellee which even faintly gives rise to this implication. Appellee quotes out of context from Chamberlin's testimony to the effect that:

> ". . . if the book overdraft resulted in a bank overdraft, that I would be, in his terms [Donald Sherwood's], and I quote 'standing alone'."[1]

Of course, the statement was not rebutted because it is quite true. The quoted statement most certainly does not relate to the Walker-Chamberlin check kiting. Appellee's implication that S&R approved of the Walker-Chamberlin check kiting, or even knew about it, is false.

Chamberlin, in trouble because of repeated overdrafts, sought to hide the matter by check kiting. But what caused Chamberlin to get into the overdraft situation? Substantial contributing factors were the Walker and Williams delinquencies which arose in large part from cars sold out of trust, NSF checks, and employee car deals (Tr. 241, 247, 523, 608, 707-710, 745, 760-765, 768, 769, 861, 862, 876, 2005, 2101).

November Loans Conceal Check Kiting And Out of Trust

Edwards expected accounts to be paid out of receivables (Pl. Ex. 84). Of course, neither Williams nor Walker could pay, thus creating an overdraft situation. Checks could not be kited indefinitely nor could

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[1] The full testimony from which this quotation is extracted is set out in the Appendix at pp. A-4 to A-7.

the Walker and Williams accounts be forever eliminated from the delinquency reports (Tr. 892). These facts gave rise to the necessity of the next act of deceit.

On November 19, 1958, Walker was out of trust $32,590.15 and was delinquent on capital loans totalling $52,114.49. At the same time the Williams obligations of $16,328.91, including NSF checks of $7,125.29, were delinquent. These mounting delinquencies, which had been concealed from Walla Walla, threw Chamberlin's cash account far out of balance as no money was being collected on these receivables. Consolidation of the Walker and Chamberlin loans provided Chamberlin with a device to conceal his earlier deceits and at the same time enabled him to hide the true status of these accounts. (R. 21, 22; Tr. 609-611, 2002, 2011, 2093-2094; Pl. Ex. 62; Appellant's Brief, A-19.) As a result of the consolidation loans made November 19 and 20, 1958, Chamberlin was able to put these accounts on a "current" basis. More importantly, the "NSF" and "out-of trust" situation could be hidden by dutifully reporting the loans on the Finance Loan Register (Def. Ex. A-10). By making these loans Chamberlin corrected his overdraft situation and successfully continued to hide out-of-trust transactions, NSF, check kiting and the desperate financial condition of Walker and Williams. Within a space of two days, Chamberlin had put obligations totalling $68,443.40 on a "current" basis, corrected his overdraft situation, and eliminated the necessity of putting the Walker and Williams obligations on the delinquency list.

The Finance Loan Register (Def. Ex. A-10) did not set out the background of any loan nor give any in-

formation on the financial stability of the borrower. In fact, the Finance Loan Register was a most useful tool for Chamberlin. It will be recalled that Chamberlin had wide authority (Appellee's Brief, p. 8). He was a fiduciary in the broadest sense. His employer relied, as it had a right to, on his honesty as a fiduciary. The reports required of Chamberlin were needed for accounting purposes. Chamberlin was free to use his best business judgment in making loans—he was not free to deceive, to lie, to conceal, to misrepresent.

Misrepresentation And Concealment of Material Facts – Fiduciary Responsibility Violated

In a leading case, Justice Cardozo said:

> "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of the courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions . . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd." *Meinhard v. Salmon,* 249 N.Y. 458, 464; 164 N.E. 545, 546 (1928); *Leppaluoto v. A. W. Larson Const. Co.,* 57 Wn. (2d) 393, 403; 357 P. (2d) 725; R.C.W. 23.01.360[2]

In the face of these facts Chamberlin loaned an additional $15,000 to Walker on his personal note to al-

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[2] See Feuer, Personal Liabilities of Corporate Officers and Directors, Chapter 5, 6 & 8 Conflict-Producing Transactions, Prentice-Hall 1961.

low Walker (according to Chamberlin) to buy parts and advertising from American Motors (Appellee's Brief, p. 52). Dion says the purpose of the loan was to enable Walker to show cash in the Rambler bank account (Tr. 783-784.)

At this point Chamberlin, having committed S&R to a $100,000 line of credit to finance the purchase of Ramblers, had to obtain authority from Donald Sherwood for S&R to guarantee the credit line. Chamberlin's testimony relative to his conference with Donald Sherwood on the guarantee is revealing, though evasive (Tr. 2113, 2114). This testimony is set out in the Appendix hereto pages A-3, A-4.

The testimony of Chamberlin and Sherwood is in conflict as to whether the November 30, 1958 financial statement of Rambler was shown to Sherwood. However, Sherwood and Chamberlin discussed the kind of dealer Walker was and Walker's financial stability (Tr. 2113, 2114). The fact that Walker had been seriously out of trust, was without funds to pay delinquencies, and even needed cash to make minimal purchases from Rambler was not revealed to Sherwood.

Chamberlin did represent to Sherwood that he had personally handled Mr. Walker's account for seven years and that "Mr. Walker's business practices have been beyond reproach" by showing him his letter to American Motors (Pl. Ex. 68).

A fiduciary must give to the corporation all the relevant and material information he possesses and can obtain on the subject of a transaction. *Cumberland Coal & Iron Co. v. Sherman,* 30 Barb. 553 (N.Y. Sup.

Ct. 1859) But appellee states at page 52 of its brief "further facts could have been had by Walla Walla for the asking."

The actions of Chamberlin conclusively demonstrate and exhibit deceit and dishonesty, not mere negligence or poor business judgment as appellee contends.

Chamberlin Takes Stock From Defaulting Borrower

On July 17, 1958, Chamberlin acquired stock in Tri-City Rambler. Whatever the reason, it is undisputed that Chamberlin did not divulge his stock interest and in fact denied it until confronted with the evidence (Tr. 1144, 1167, 1168, 1169, 1355). If, as he claims, he had no present interest in the stock and in fact didn't want it, why did he first hide and later deny his ownership?

> "... the taking of a private profit violates the [fiduciary] principle of undivided loyalty and is deemed fraudulent. . . ." *Pollitz v. Wabash R.R.,* 207 N.Y. 113, 127; 100 N.E. 721, 724-725 (1912); *Pigeon Point Ranch, Inc. v. Edward S. Perot, et al,* 28 Cal. Rptr. 865; 379 P. (2d) 321 (1962); *Continental Sec. Co. v. Belmont,* 206 N.Y. 7, 18; 99 N.E. 138, 142 (1912); *Bailey v. Jacobs,* 325 Pa. 187, 200; 189 Atl. 320, 327 (1937).

Each concealment to the date of the Sherwood conference in January, 1959 was built one upon the other, each necessitated by an earlier deceit. But the acts of deception did not stop. They continued and, like a cancer, grew on past deception.

July Loan Perpetuates Dishonest Concealments and Misrepresentations

By April, 1959, the Walker accounts were again delinquent. Again the overdraft situation arose. Be-

tween April 20 and 23, checks in the sum of $39,000 were kited between Walker and Chamberlin.

From March 31 to July 31, 1959, S&R found it necessary to advance $101,000 to Kennewick to correct overdrafts (Tr. 1670). On July 31, 1959, the Walker loans were again delinquent. Once again the loans were consolidated for $47,716.91. The necessity to place Walker on the delinquency list had been evaded. On this loan additional security was not obtained — security was released. Palmer Walker, once liable personally on the entire debt, was released except for the first $15,000. Substantial assets of Walker Motors, Kennewick and Union Gap, were released. To be sure, some assets were transferred to Tri-City Rambler, but the net result was a substantial loss of security (R. 20-23; Tr. 772-776, 796, 798, 801, 873-874, 1065-1073).

The new loan was duly reported on the Finance Loan Register, but the delinquencies necessitating the loan and the loss of security were not. Chamberlin testified at length that the November loans had been well secured. When questioned about the July loan, he opined that all the earlier security was not necessary (Tr. 2027-2033).

Chamberlin denies all knowledge of Walker's financial statements. When pinned down, however, he admits having statements in his file for February and March, 1959 (Tr. 2120), the fall of 1959 (Tr. 2118, 2119), and for early 1960 (Tr. 1751, 1778, 1780, 2128-2130). Each of these statements was fraudulent (Pl. Exs. 53, 53A-F, 54, 54-A, 55, 55-A, 56; Def. Exs. A-17, A-32, A-33; Tr. 657, 658, 1386). The loans made by

Chamberlin were not reflected honestly in these statements. Chamberlin alone, in the S&R organization, was aware of the facts which showed the statements to be false on their face. Yet Chamberlin permitted both the bank and Strong to rely on their accuracy without explanation. This is not conjecture, for one need only examine the face of these statements in light of the Chamberlin loans to realize their fraudulent nature (Pl. Exs. 68-A, 74, 75, 76, A-17).

It is admitted that between October 1, 1958 and March 25, 1960, an additional 22 cars representing $49,440.93 were sold out of trust (R. 23; Tr. 760; Exs. 61, 62, 63). Chamberlin's excuse is that a mixup with Rambler prevented him from determining the true picture for 60 days. But six months, not 60 days, elapsed after Chamberlin was informed of the situation (Tr. 772-776, 873-874, 876, 2033; Pl. Exs. 63, 64, 65). Yet at the time of the Strong report of February, 1960, Chamberlin was still practicing his deception through the use of Walker's fraudulent statements and complete silence on the Walker-Chamberlin dealings that had transpired since 1957.

Accordingly, having reported to Walla Walla only skeletal facts relating to Walker, Chamberlin in March, 1960, took control of the situation and proceeded to negotiate privately through his attorneys for some type of saving agreement that would continue to hide the past deceptions and be exculpatory of both Walker and Chamberlin.

Chamberlin was attempting to repeat in 1960 the successful concealments made possible by the Novem-

ber, 1958 and July, 1959 loan consolidations. On this occasion, though, conditions had become so bad that he was forced to divulge some information to S&R in February and March, 1960. Thereafter he took control of the situation. The proposed Refinancing Agreement (Def. Ex. A-23) did not reveal the true state of Walker's financial condition and did not reveal Chamberlin's past deceptions. Basically this proposed agreement called for the infusion of large amounts of capital into Walker's operation. Had the agreement been signed, Walker would have again been put on a current basis and Chamberlin's manifold deceptions would have had to wait future discovery.

It is to be noted that the proposed agreement prepared by Chamberlin and Robert Day was never presented to Walla Walla until ready for signature (Tr. 1845). The Englund report delayed consummation of the agreement and resulted in S&R's insistence on a complete audit (Defs. Ex. A-20; Tr. 1632-1634).

Yet Chamberlin, aware of the true gravity of the situation, on May 2, 1960 made a $9,000 unsecured loan to Walker thus worsening an already critical situation. This loan appeared on the Finance Loan Register, but not until month's end.

A bad loan can be excused on the basis of poor business judgment or negligence. But each loan made by Chamberlin represented a cover-up of material facts. When the first deception was followed by an ever-widening pattern of deception calculated to hide past deceptions as well as current, such acts cannot be dismissed as negligence or poor judgment.

Chamberlin was a fiduciary entrusted with the care of large amounts of money not his own (R.C.W. 23.01.-360). His duties as a fiduciary required at the very least strict accountability of funds. Because he violated his duty of honest disclosure, his duty of accountability, and because he pursued a calculated course of deception, the Walker losses ballooned to more than $127,000. Of this sum more than $80,000 is directly attributable to cars sold out of trust.

The fact pattern of the Walker-Chamberlin deals emphasizes the error of the Court in requiring the jury to find that Chamberlin intended to defraud S&R. St. Paul did not impose the requirement of "intent to defraud" in the bond. We wish to point out that St. Paul agreed to pay losses resulting:

> "By reason of the *fraud, dishonesty,* forgery, theft, larceny (whether common-law or statutory), embezzlement, wrongful abstraction or misappropriation, *or any other dishonest,* criminal or fraudulent act . . . whether committed directly or in connivance with others." (Pl. Ex. 1.)

St. Paul used the word 'dishonesty' twice, once together with all crimes of intent and again to include *"any other dishonest . . . act"*. This covenant is as broad as it could be made. Having once stated that the bond insured against any dishonest act, it would be redundant to insure also against any other dishonest act unless to eliminate any possibility that intent to defraud be made a condition of liability.

"Contracts of insurance, like other contracts must be construed according to the terms which the parties have used, to be taken and understood, in the absence

of ambiguity, in their plain, ordinary and popular sense." *Bergholm v. Peoria Life Insurance Co.,* 284 U.S. 489; 52 S. Ct. 230-231; 76 L. Ed. 416.

Concealment and misrepresentation of material facts are dishonest acts. Each of Chamberlin's concealments and misrepresentations was done with an intent to deceive, but intent to commit a dishonest act and intent to defraud are two vastly different things.

The cases cited by both parties require that a dishonest act be done intentionally and not as the result of negligence. The case of *Mortgage Corporation of N. J. v. Aetna Casualty & Surety Co.,* 115 A. (2d) 43, discussed at length by both parties, holds simply that conduct which is wilfully, intentionally and grossly faithless is conduct which is intentionally dishonest. The Aetna case distinguishes dishonesty from fraud. It does not require that an employee intend to harm his employer. It requires that the employee do an intentionally dishonest act.

The Court ignored the distinction between fraud and dishonesty imposed by the repeated use of the word 'or' in the bond, and by requiring the jury to find "intent to defraud". Thus the element of dishonesty was eliminated from the case. Plaintiff's requested instruction No. 31 would have corrected the error if the instructions objected to had been eliminated or modified to omit the requirement of intent to defraud.

C. THE NICHOLSON TRANSACTIONS

The full story of the Nicholson transactions is set forth at pages 31-39 and 64-67 of our opening brief.

Appellee denies that Chamberlin converted the Simca car or the check for $454.21 (Pl. Ex. 35). These denials are unsupported by any reference to the record.

The evidence detailed by us in respect to the $454.21 check is sought to be refuted by the following statement alone (Appellee's Brief, p. 37):

> "Although the rebate charges of $454.21 were credited to Nicholson's loan, the check was written directly to Fairway Finance—Kennewick, covering this item in accordance with the bookkeeping practices of S&R." (Plaintiff's Exhibit 35)

Appellee ignores the undisputed evidence. The $454.21 check was issued one day after credit was given Nicholson, was endorsed in blank by Fairway and ultimately made up part of the cash receipt for which Chamberlin admits he received credit (Tr. 291).

Conversion of the Simca car is explained by appellee by the following statement:

> "Chamberlin paid the $1,300 to S&R by making a loan with S&R on his MG." (Appellee's Brief p. 38).

Appellee admits that the Simca was used as a trade-in on the MG while failing to deny that, at the time of the trade, the Simca was owned by S&R. Appellee gives no explanation nor cites any reference to demonstrate the manner of repayment. The Nicholson and Chamberlin loan accounts do not reflect payment (Pl. Exs. 26, 27, 28, 37, 38). Even if appellee's contention is accepted, the fact remains unaltered and undenied that Chamberlin converted the Simca when he traded this car, the property of S&R, for the MG.

We earnestly urge the court to examine Exhibits 26, 27, 28, 29, 30, 31, 32, 33, 35, 37, 38 and A-10. These ex-

hibits, supported by the testimony cited by both parties in their briefs, demonstrate Chamberlin's conversions beyond any reasonable doubt.

A bank teller who made the same use of bank funds that Chamberlin did of the Simca and the $454.21 would be an embezzler. Is Chamberlin less an embezzler because he converted a car and a check?

D. THE SECURITIES ACCEPTANCE CORPORATION MATTER

Appellee admits that Chamberlin used suspense account funds for the period January 31, 1958 through March 6, 1958 (Appellee's Brief 38-39). The real importance of this transaction (this is only one example taken from the record and there were many) lies not in the fact that Chamberlin avoided the payment of interest, but that he "borrowed" without permission funds owned by others for his own use (Tr. 1673-1677). The fact that he repaid the money does not distinguish this action from any other case of embezzlement (R.C.W. 9.54.010(3)). It matters not that Chamberlin travelled a great deal during this period. The wrong occurred at the moment Chamberlin took money from the suspense account. Since the suspense account had to be closed at the end of every month and the account balanced at zero, unpaid borrowings had to be replaced. Unauthorized suspense account withdrawals could have contributed to the overdraft situation.

E. LIVINGSTON-BLACKBURN DEAL

Twenty-five dollars is a small sum. Appellee admits Chamberlin received this amount as the difference be-

tween the Livingston and Blackburn sale prices (Appellee's Brief, p. 39). Chamberlin was entitled to nothing. This sum should have gone to Livingston, Blackburn, Williams or S&R. A small amount, perhaps, but symptomatic of all the Chamberlin dealings.

ERRORS 6 AND 7
THE COURT ERRED IN EXCLUDING THE ADMISSIONS OF ST. PAUL'S AGENT

Rivon Jones was a claims agent and attorney for St. Paul. Admissions were made by Jones while in the process of adjusting S&R's claim and were within the scope of the business he was authorized to transact. Jones was not available as a witness since St. Paul claimed privilege (Tr. 1472). An attorney or agent who makes an admission within the scope of special authority (e.g. claim adjusting) may bind his client. 7 Am. Jur. (2d), Attorneys At Law, §122, p. 122; *Armstrong v. Goldberg,* 190 Wash. 210, 67 P. (2d) 328. Jones had no motive to falsify, the facts were known to him, and the statement was against St. Paul's pecuniary interest. The excluded testimony was proper as rebuttal and as an admission.

CONCLUSION

Chamberlin's actions may be summed up by a paraphrase of a quotation from the Aetna case set out in appellee's brief at the top of page 63.

> "It seems to us that in the instant matter we likewise could not properly stand by and permit the jury finding that the *admitted or undenied* derelictions of Chamberlin were not dishonest within the bond coverage. We are not dealing with an instance of neglect,

mistake or incompetence; *nor are we dealing with an isolated inadvertent or insignificant delinquency by an employee. What Chamberlin did was done wilfully over a period of thirty months.*" (Emphasis supplied)

Robert Chamberlin may not have intended to harm S&R or deprive it of a right. Intent to harm or deprive are tests of fraud, not dishonesty. An intentionally dishonest act may be committed absent the motives of harm or deprivation. Dishonesty is defined as:

"Want of honesty, probity, or integrity in principle; want of fairness and straightforwardness; a disposition to defraud, deceive or betray; faithlessness." *Webster's International Dictionary, Second Edition.*

One is presumed to intend the consequences of his acts. It follows that one who intentionally commits a dishonest act, but without "intent to defraud", is responsible for any loss sustained. This was the intent of the bond.

St. Paul insured against dishonesty. The court eliminated that issue when it compelled the jury to find "intent to defraud."

We submit that Chamberlin was guilty of dishonesty as a matter of law, and in fact was guilty of fraud and embezzlement.

We respectfully urge that each of the points raised upon appeal is well taken and warrants reversal.

Respectfully submitted,

WILLIAM M. TUGMAN
SHERWOOD, TUGMAN AND GREEN
Attorneys for Appellant

CERTIFICATE

I, the undersigned, do hereby certify that in connection with the preparation of this Reply Brief, I have examined Rules 18 and 19 of the U. S. Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing Brief is in full compliance with those Rules.

WILLIAM M. TUGMAN

SHERWOOD, TUGMAN AND GREEN
Counsel for Appellant

APPENDIX
OF
APPELLANT

APPENDIX

Exhibit 84

SHERWOOD & ROBERTS, INC.

Post Office Box 1020 106 North Second Avenue Telephone JA 5-3500

WALLA WALLA, WASHINGTON

Date 10-10-58

To Robert Chamberlin
Sherwood & Roberts—Kennewick, Inc.

From Bert R. Edwards

Subject An Outline of Pending Matters

4. Confirming our conversations with respect to cash control at all of your offices in the Tri-City area, please be assured of our earnest effort to get you on a sound basis. In advancing $12,000.00 October 8 to Sherwood & Roberts-Kennewick, we did so on your statement that the advance would repay all borrowings from Fairway. It is agreed that you will not permit or countenance any inter-company borrowings in your offices except advances from Sherwood & Roberts-Kennewick to your Richland office. If you need additional funds to overcome book overdrafts, please advise me and the funds will be advanced accordingly. Effective immediately we will not countenance a bank overdraft on any account in your office nor will we permit a book overdraft to go unexplained. We expect to review your cash reports daily. The record shows that Fairway Finance Company-Kennewick had four bank overdrafts in September, seven overdrafts in June, four overdrafts in July and a monthly bank service charge in excess of $80.00.

Upon receipt of your request for funds to correct all overdrafts, we shall place you in a workable position for the last time. You may anticipate that any advances made are temporary and subject to repayment prior to year's end as quickly as you can amortize loans receivable.

5. To place your transfer of loans to Richland in a workable accounting position, we have advanced $63,000.00 to Sherwood & Roberts-Kennewick for transfer to Sherwood & Roberts-Richland. $45,000.00 has been paid by Richland to Fairway Finance Company-Kennewick and then by Fairway Finance-Kennewick to Fairway Finance-Walla Walla. $18,000.00 has been paid by Richland to Sherwood & Roberts-Walla Walla. This clears the transaction satisfactorily.

6. Prior to the close of business in October would you please furnish us a list of all receivables due from employees by name, amount, security, date of last payment and remarks.

7. It would be to your advantage to clear Cabadab off the record prior to the close of business in October.

   It would be of material assistance for you to prepare a statement with respect to the discontinuance of wash transactions with Walker Motor Company.

As I told you earlier this week when we were together in Walla Walla, we have a high regard for your energy and application to the duties of your office and for your ability to produce a volume of business and

to inspire your associates in the handling of this volume. Some of the practices in your office are the acme of the hard way of accomplishing an objective. You should call upon the specialized staff at Walla Walla for assistance in smoothing out some of your problems. We are all willing to help you improve your procedures and reduce your overhead.

Kindest personal regards and best wishes.

SHERWOOD & ROBERTS, INC.

vkf

CHAMBERLIN — CROSS

(Line 21, Page 2113 thru Line 21, p. 2114)

Q. Isn't it a fact, Mr. Chamberlin, when you came to see Mr. Sherwood that you brought your file, your dealer's file, with you?

A. I brought the file pertaining to it, yes.

Q. And isn't it a fact, Mr. Chamberlin, that Mr. Sherwood when you mentioned you were taking on this line of flooring asked you questions about it?

A. We discussed it.

Q. Isn't it a fact that he asked you what kind of a dealer Mr. Walker was, or European Motors?

A. I think he did, yes.

Q. Did he ask you about the financial stability of Mr. Walker or European Motors?

A. I think there was some discussion, yes.

Q. Didn't you have with you at that time your letter of December 18th to American Motors?

A. I think a copy of it would have been in the file, yes.

Q. And didn't you show that letter to Mr. Sherwood and let him read it?

A. I could have, yes.

MR. LONEY: Exhibit 68, if I may.

(The exhibit was handed to Mr. Loney.)

Q. And isn't it true that in that letter you showed to Mr. Sherwood you represented that Mr. Walker's business practices have been beyond reproach?

A. That statement was in the letter, yes.

CHAMBERLIN — DIRECT

(Line 3, p. 2019 through line 25, p. 2021)

Q. What was the situation with reference to your daily cash register? I don't know whether I have spoken of it correctly by name. The daily cash situation.

A. The daily cash summary?

Q. Yes.

A. Was a record that was kept daily. It showed the disbursements and the deposits of the previous day and the cash balance.

THE COURT: Cash register, do you call it?

A. Yes.

Q. (By Mr. Palmer) Now, you have told us what it was, but what was the situation?

A. Well, the situation during this period of time was that we were showing a book overdraft daily, and which indicated we did not have enough funds to cover our commitments, or our disbursements.

Q. Did Mr. Edwards advise you that he didn't like it?

A. Yes, he did.

Q. Did you later take up this book overdraft situation with Donald Sherwood?

A. I did not take it up with him. He called me and related that he was conscious of what was — what the situation was, wanted to put me on notice that a book overdraft was one thing. However, if the book overdraft resulted in a bank overdraft, that I would be, in his terms, and I quote, standing alone. In other words, —

Q. That's what he said?

A. Right. I might explain, I don't want to create the impression that Sherwood & Roberts was financially — had problems on credit lines. A lot of the problems stems from the fact that you may have a line at a bank and say the maximum line that the bank can loan to one borrower might be, for the sake of illustration, a million dollars. So when that line was reached, through no fault of Sherwood & Roberts or the bank either, when the maximum had been reached that that bank could loan to an individual borrower, it served the same pur-

pose as being out of money. But I do want to make that statement.

Q. Very well.

THE COURT: I would like to ask a question.

THE WITNESS: Yes, sir.

THE COURT: Was this a period, if you know, when the commercial banks generally were starting to tighten up on their loans or liberalize them, or what was the sitlation?

A. I do not know that. I do know, however, that Mr. Sherwood attempted to arrange these bank lines, and sometimes his predictions would fall short and we would run into a tight money situation.

Q. (By Mr. Palmer) Now, did Mr. Sherwood call you when the home office or the parent corporation had additional funds to put into your outstandings?

A. Yes, he would. On occasion another office would dispose of a line and there would be a surplus of funds, Mr. Sherwood would call me and state, "We're back in business. Have X number of dollars, and let's get it out."

Q. Now, why did you make these exchange of checks with Walker Motor Company, Inc.?

A. The exchange of checks with Walker Motor were for the purpose of erasing the book overdraft so

that on the end of each month when we made our closing, why we would show a cash balance.

Q. Was this stopped after December 31, '58?

A. No. As I recall, there were a couple incidents in 1959, the spring of 1959.

Q. Did it occur after that?

A. No, it did not.

Q. Now, —

THE COURT: Do you mean it didn't occur after the couple of instances in 1959?

A. Yes.

MR. PALMER: I think the exhibit shows one instance, your Honor, in 1959."